

**STATE OF WISCONSIN
DEPARTMENT OF EMPLOYEE TRUST FUNDS
801 West Badger Road
Madison, WI 53702**

CORRESPONDENCE MEMORANDUM

DATE: October 14, 2002

TO: Deferred Compensation Board

FROM: Robert Willett
Chief Trust Financial Officer

SUBJECT: Participant Fee Recommendations

The Wisconsin Deferred Compensations plan (WDC) maintains an administrative account that is used to pay the administrative expenses for the plan. These expenses are primarily for the administrative services contract with Nationwide Retirement Services, but also include expenses for Employee Trust Funds staff, audits and other plan expenses.

Revenues to fund administrative expenses come from participant fees, investment provider reimbursements, and interest income on the account balance. During the most recent twelve months, the following revenues and expenses were recorded in the administrative account.

Wisconsin Deferred Compensation Administrative Account In thousands \$	
September 1, 2001, Account Balance	\$ 2,320
Revenues	
Participant Fees	1,092
Investment Provider Reimbursements	867
Interest	124
Total Revenues	2,083
Expenses	
NRS Contract	2,166
ETF & Miscellaneous	156
Total Expenses	2,322
August 31, 2002, Account Balance	\$ 2,081

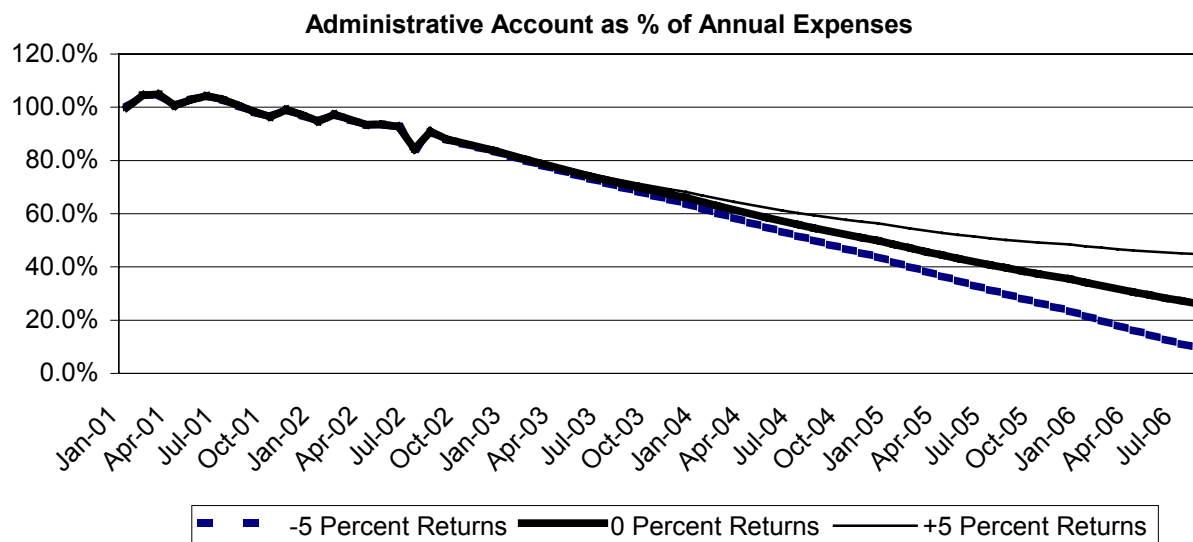
The WDC's goal for the administrative account is to maintain an account balance equal to 50% of the annual operating expenses. This balance assures that funds will be available to pay expenses when due and provides a cushion against reduced participant fees and investment provider reimbursements that could occur during a market downturn. During the period shown above, the account balance dropped from approximately 100% of annual expenses to 90%.

The participant fees shown above are based on a tiered fee schedule that has been in effect since February 1, 2000. At that time, the Board replaced the traditional basis point fees with a tiered fee schedule and reduced total fees by almost 30%. The current fee schedule is shown below:

Account Balance	Monthly Fee
\$0 to \$5,000	\$ 0.50
\$5,001 to \$25,000	\$ 1.50
\$25,001 to \$50,000	\$ 3.00
\$50,001 to \$100,000	\$ 6.00
\$100,001 to \$150,000	\$ 8.33
\$150,001 and up	\$ 10.00

Although the tiered fee structure reduces the volatility of participant fees, overall fees are still very dependent on market performance and account balance growth. The fee schedule adopted in 2000 assumed moderate future investment gains and was targeted to slowly reduce the administrative account balance to 50% of annual expenses. Modeling showed that under continued high investment returns the administrative account balance would continue to grow and further fee reductions would be possible. Conversely, a market decline would reduce the administrative account more rapidly, and an extended bear market could make a fee increase necessary at some point in the future.

With twenty months of experience under the new fee schedule, we have updated the fee projections with three new investment return scenarios. The administrative account balance as a percent of annual expenses has been projected using -5%, 0 and +5% annual future investment returns. The results are charted below.



Assuming 5% annual future investment returns, the account balance would drop to approximately 70% of annual expenses in the next year but ultimately level out near the 50%

target. No change in participant fees would be necessary in the foreseeable future under this assumption.

Assuming 0% annual future investment returns, the account balance would drop to approximately 68% of annual expenses in the next year, pass through the 50% target in approximately December 2004 and continue falling. Under this assumption, no action would be needed until your review of participant fees in November 2004, at which time a fee increase may need to be considered.

Assuming -5% annual future investment returns, the account balance would drop to approximately 66% of annual expenses in the next year, pass through the 50% target in approximately August 2004 and continue falling. Under this assumption, no action would be needed until your review of participant fees in November 2003, at which time a fee increase may need to be considered.

Under any reasonable assumptions the administrative account balance will remain above the 50% target for the next year. At that time the Board will have another opportunity to review and adjust participant fees if needed.

My analysis has not incorporated behavioral changes that may occur in a sustained bear market. We have already seen evidence of participants moving significant amounts from equity funds into safer fixed income alternatives. This behavior could intensify if the market losses continue. Increased allocations to fixed income options result in account balances that are less impacted by market declines, stabilizing account balances and participant fees. The offsetting impact is that fewer funds are invested in equity funds, which offer provider reimbursements to the plan, reducing this source of income.

It is my recommendation that the Board take no action to change participant fees at this time. Under a worst case scenario, it may be necessary to consider raising fees a year from now, though more probable assumptions suggest that no change in fees will be required in the foreseeable future.

I will be available at your November 12 meeting if you have any questions on my analysis or recommendations.